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CHARLES E. ROBERTSON

IN THE
Supreme Court of the United States
OCTOBER TERM, 1947

No. 365

EDWARD R. DOWNING, etc.,
Petitioner,
against

GEORGE H. HOWARD, et al.,
Respondents.

BRIEF IN BEHALF OF RESPONDENTS HOWARD, CHUBB,
STACY, STURGES, BURNS, LUCKETT, FERGUSON, BURR,
O. K. ANDERSON, DUMAINE, HICKEY AND SMITH, IN OP-
POSITION TO PETITION FOR WRIT OF CERTIORARI

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Statement

This is a derivative action brought by a stockholder of The United Corporation seeking to recover as against former and present officers and directors, and third persons allegedly acting in conspiracy with them, damages for alleged waste of corporate assets and an accounting for alleged profits.

NOTE: All references to the record before the Court below, and to the record of the further proceedings in the Court below, are in page numbers. Unless otherwise noted, italics in quoted matter are supplied.

The amended complaint, filed August 14, 1945, alleged three causes of action (R. 11a, 39a, 48a). Federal jurisdiction of the subject matter, as well as personal jurisdiction of all but three of the individual defendants and the venue of the action, was based and depends solely upon Section 25 of the Public Utility Holding Company Act [15 U. S. C. A. § 79y] (R. 3a-8a, 12a, 39a, 48a). This is conceded by the petitioner (Petition, p. 2),

As the record below shows (R. 71a-101a), the respondents' several motions to dismiss in the District Court raised primarily the question as to the existence of the claimed Federal jurisdiction under Section 25 of the Public Utility Holding Company Act. The District Court decided this question against the petitioner's claim and granted the respondents' motions to dismiss on the ground that the Court lacked jurisdiction over the subject matter of the action (R. 126a, 144a). The Circuit Court of Appeals in its opinion, filed June 24, 1947, reported in 162 F. (2d) 654, likewise decided this question against the petitioner's claim and unanimously affirmed the judgment of dismissal entered in the District Court (R. foll. 152a).

ARGUMENT

POINT I

The Circuit Court of Appeals correctly decided that the amended complaint failed to show a basis for recovery under the Public Utility Holding Company Act and that, in consequence, the claimed jurisdiction herein based on Section 25 of the Act did not exist.

Despite the "highly unusual position" taken by the plaintiff in the Court below that "his general claim for mismanagement does not state a cause of action at all" (R. foll. 152a, p. 2), the fact remains that the plaintiff's claims against the individual defendants are based essentially upon

express allegations of breach of common law "fiduciary" duties as officers and directors, or negligence in the performance of those duties. The blanket allegations in the amended complaint as to "violations" of the Public Utility Holding Company Act by the Corporation are superimposed upon these essential allegations merely to give a semblance of Federal jurisdiction in the matter. They have no legal relation to the causes of action attempted to be alleged in the amended complaint or to the relief therein sought.

In the first cause of action alleged against former officers and directors, the plaintiff, after reciting the failure of the Corporation to register as a holding company under the Act during the period from December 1, 1935 to March 28, 1938, and the retention by the Corporation of certain portfolio securities during that period in "violation" of Section 4(a) of the Act (R. 29a-30a), states in Paragraph THIRTY-EIGHT (R. 32a) that such acts and omissions—

"were committed in furtherance of a fraudulent conspiracy by the defendants to waste and dissipate the assets of United and to profit at the expense of United by means of said acts and failures to act. In taking part in said conspiracy and the fraudulent acts and omissions pursuant thereto the directors of United conducted themselves in wrongful violation of their fiduciary duties to United and the other defendants knowingly participated in and wrongfully induced such breach of fiduciary duty."*

* The amended complaint (R. 32a-36a) then goes on to state that the "conspiracy to profit at the expense of United included, as an essential element thereof, the continued ownership and holding by United of the aforesaid securities of the subsidiaries"; to claim certain relationships between the officers and directors of United and certain third parties alleged to have acted in conspiracy with them; and to claim damages measured by the difference between the market value of the securities as of December 1, 1935 (when non-exempt holding companies were required to register under the Act) and the market value of the securities as of March 28, 1938 (when United registered as a holding company under the Act).

In the second cause of action alleged against former officers and directors, the plaintiff, after referring to the Corporation's exchange of certain securities in 1937 in connection with the Niagara Hudson Power Corporation-Mohawk Hudson Power Corporation consolidation, in "violation" of Section 4(a) of the Act (R. 40a-42a), states in Paragraphs FIFTY-FOURTH-FIFTY-FIFTH (R. 43a) that such acts and failures——

"were committed in furtherance of a fraudulent conspiracy among the defendants to waste and dissipate the assets of United and to profit at the expense of defendant United, by means of said acts and failures to act."

and that, by such acts and failures, the individual defendants who were officers and directors of United——

"committed a breach of their fiduciary duties to defendant United, and were guilty of gross negligence in the discharge of said duties."*

In the third cause of action alleged against all the defendants, including the present officers and directors of the Corporation and those individuals who became officers or directors on and after March 28, 1938, when United registered as a holding company under the Act (R. 29a), the plaintiff, after asserting that United retained certain portfolio securities from January 1, 1936 to 1944 and failed to file with the Securities and Exchange Commission a proper plan for the divestment of securities in "violation" of Section 11 of the Public Utility Holding Company Act (R. 51a-55a), states in Paragraph SEVENTY-EIGHTH (R. 55a) that such acts——

"constituted gross negligence and a fraudulent breach of their fiduciary duties as directors and

* The amended complaint (R. 43a-45a) attempts to spell out, on the basis of a comparison of subsequent declines in the market value of securities, alleged losses suffered by United as a result of the exchange of portfolio securities in connection with the aforesaid consolidation.

officers of said defendant, United. The other defendants knowingly participated in and induced said breach of fiduciary duty by said directors.”*

Thus, a mere reading of the complaint shows that the Circuit Court of Appeals correctly decided that the plaintiff had failed to show a basis for recovery under the Public Utility Holding Company Act and that, in consequence, the claimed jurisdiction of the subject matter based on Section 25 of the Act did not exist. Not only is there no basis whatever for the plaintiff's claim that the Corporation's failure to file a proper plan for divestment of securities constituted a violation of Section 11(e) of the Act [15 U. S. C. A. § 79k] (see *American Power & Light Co. v. SEC*, 329 U. S. 90, 119, 123, 67 S. Ct. 133, 149, 151 (1946); *Commonwealth & Southern Corp. v. SEC*, 134 F. (2d) 747 (C. C. A. 3rd, 1943)); but it is obvious, in view of the claims asserted in the amended complaint, that the alleged “violations” of Section 4(a) of the Act attributable to the Corporation's failure to comply with the registration provisions of the Act, were not the proximate cause of the losses for which the plaintiff seeks redress and, accordingly, afford no ground for federal jurisdiction herein (see *Herrmann v. Edwards*, 238 U. S. 107, 35 S. Ct. 839 (1915); *Meyer v. Kansas City Southern Ry. Co.*, 84 F. (2d) 411 (C. C. A. 2nd, 1936) *cert. denied* 299 U. S. 607, 57 S. Ct. 233 (1936)).

Moreover, with the failure of jurisdiction over the subject matter based on Section 25 of the Act, personal jurisdiction based on the same Section is also lacking and the venue of this action is clearly improper as to all of the individual defendants who were not served with process within the District of Delaware, and are not residents or inhabitants

* In this instance, the damages are vaguely stated (R. 60a) to be “at least in sums equal to the difference between the value of such shares of stock at the time when this court determines they should have been disposed of, and the present value thereof.”

of that District (see Rule 4, Federal Rules of Civil Procedure [28 U. S. C. A. foll. § 723(c)]; Section 51 of the Judicial Code [28 U. S. C. A. § 112].

POINT II

This case does not present any question appropriate for this Court to review.

As appears from Judge Goodrich's opinion below (R. foll. 152a), the Circuit Court of Appeals' decision of affirmance was based primarily upon its determination that the allegations of the complaint were insufficient to establish a causal relation between the damages for which recovery was sought and the "violations" of the federal statute in question. Thus, the Court's decision involved merely a construction of this particular complaint rather than an interpretation in any fundamental sense of the Public Utility Holding Company Act of 1935.

The Circuit Court of Appeals did not, as the petitioner suggests throughout his petition and supporting brief, rule, expressly or by implication, that the failure of a public utility holding company to comply with the registration provisions of the Act could not be made the basis of a private right of action under the Act. On the contrary, this question was left open and the existence of such private right of action was assumed by the Court in determining whether or not the amended complaint stated a basis for recovery under the Act.

In the concluding paragraph of his opinion, Judge Goodrich said (R. foll. 152a, p. 9):

"Our conclusion is, with regard to plaintiff's first and second claimed causes of action, that we need not commit ourselves on the question whether violation of registration requirements may in some circum-

stances be made the foundation of assertion of private rights. We shall answer that question when a case compels us to do so. It is sufficient to say that such circumstances are not here presented by the plaintiff. We think that here, even if the violation of the statute could be made the basis of recovery, this plaintiff has not, even when we take all his allegations as true, brought himself into the area of recovery. * * *

The Petition Misstates the Questions decided by the Circuit Court of Appeals

The principal defect in the petition for certiorari is in its incorrect statement of the questions presented to the Court. It will be noted that the petition (pages 10-11) defines each of the three questions upon which review is sought as involving "*damages and profits resulting from their [the individual defendants'] actions in wilfully causing such company while unregistered * * **" to do or fail to do certain things. Such phrasing, we think, may be calculated to circumvent the only issue considered and decided by the Circuit Court of Appeals. It was the confusion of the allegations on the point of causation which led the Circuit Court of Appeals very carefully to limit its decision in this case. This confusion is now sought to be injected into the pending petition. The Circuit Court held only that *the complaint contained no allegations which, if true, would establish that the loss or damage complained of was caused by or resulted from the claimed violations by the Corporation of the Holding Company Act.*

The Court summarized this basic defect of the complaint as follows (R. foll. 152a, pp. 7-8):

" * * * It [United] would still have held the shares. The plaintiff does not, nor could he, allege that the shares would necessarily have been disposed of had the company registered since the statute gave no mandate to a registered company that it must divest itself of the securities. *The loss to shareholders in a declining market would have been just exactly the same*

whether the company was registered or whether the company was not registered. Plaintiff does not allege that the loss in value in United's securities was due to failure to register. We do not see how, in the nature of things, there could be any possible connection between the mere failure to register and the decline in value in United's shares in other companies. The only possible theory on which any such responsibility could be imposed is, we think, the proposition that the statute-violator becomes an insurer against loss of every kind. This, as already pointed out, is not the law."

And so, the Court also stated its conclusion on the matter as follows (R. foll. 152a, p. 10) :

*" * * * We think plaintiff, although he has presented his case with great skill, has failed to show any legal connection between the violation of the Act and the loss. * * * "*

The phraseology of the petition is much too oblique in the presentation of questions claimed to be involved in this case. The basic question presented may be summarized much more directly and succinctly as follows :

May a minority stockholder whose essential grievance relates to a claimed breach of fiduciary duty by corporate officers hoist himself into a federal court by alleging a concomitant, but logically unrelated, violation of a federal statute?

Both the District Court and the Circuit Court of Appeals answered this question in the negative; an answer which, upon the face of this particular complaint seems elementary and obvious, and most certainly involves no broad and significant interpretation of law or statute sufficient to warrant a further review by this Court.

It may be observed, moreover, that the petitioner himself now seems to recognize that the gist of his complaint is

the fancied breach of a common law duty of corporate officers. Faced with the undeniable fact, with respect to the third cause of action in the complaint, that no primary duty is imposed upon corporate officers under Section 11 of the Act, the petitioner now argues (Petition and Brief, pages 40-41) that the statute, by conferring privileges which might have been availed of, "enlarged the fiduciary obligations of the defendants and required that they act for the best interests of security holders, as envisaged by the act rather than in the interests of the affiliated banking interests who dominated and controlled United."

If the petitioner's argument means anything at all, it means merely that the failure to file a voluntary plan under Section 11(e) might be considered a factor in weighing a charge of corporate mismanagement. But the action, if it existed at all, would be a common law action and not one "created" by the statute or one as to which a federal court has jurisdiction under Section 25 of the Holding Company Act.

The Circuit Court's decision is not in conflict with decisions of this Court or of other Circuit Courts

As bearing upon the petitioner's further suggestion (Petition, pp. 12-13) that the decision below is in probable conflict with the decision of this Court in *Texas & Pacific Ry. Co. v. Rigsby*, 241 U. S. 33, 36 S. Ct. 482 (1916), and the decision of the Second Circuit Court of Appeals in *Goldstein v. Groesbeck, et al.*, 142 F. (2d) 422 (C. C. A. 2nd, 1944), *cert. denied* 323 U. S. 737, 65 S. Ct. 36, it is to be noted that, in the opinion below, Judge Goodrich not only recognized the doctrine of the *Rigsby* case by his reference to Section 286 of the Restatement of the Law of Torts (R. foll. 152a, p. 5), but also recognized the decision in the *Groesbeck* case as authority for the proposition that a private right of action may exist for acts done in violation of Section 4(a)(2) of the Act (R. foll. 152a, p. 7, n. 16).

Indeed, in this latter connection, Judge Goodrich specifically stated (R. foll. 152a, p. 7) :

“We are unwilling to take the position urged by the defendants that the violation of the registration provisions of the statute will never bring about individual liability. Violation has been held liability creating in one situation. It may or may not be in others. This case is decided on a narrower ground.
* * *”

CONCLUSION

The decision of the Circuit Court of Appeals on the narrow issue presented to it was clearly correct. It involved no broad interpretation of the Statute in question and it is not in conflict with any other decisions of this Court or of other Circuit Courts. Accordingly, the petition for a writ of certiorari herein should be denied.

Respectfully submitted,

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